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Management Insights

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Does Diversification Create Value in the Presence of External Financing Constraints? Evidence from the 2007–2009 Financial Crisis (p. 905)

Venkat Kuppuswamy, Belén Villalonga

Does diversification create value in the presence of external financing constraints? The authors show that the value of corporate diversification increased during the 2007–2009 financial crisis. Diversification gave firms both financing and investment advantages. First, conglomerates became significantly more leveraged relative to comparable focused firms. Second, conglomerates' access to internal capital markets became more valuable, not just because external capital markets became more costly but also because the efficiency of internal capital allocation increased significantly during the crisis. The insight for management: The value of diversification varies with financial constraints and economic conditions, and corporate diversification may serve an important insurance function for investors.

IQ and Mutual Fund Choice (p. 924)

Mark Grinblatt, Seppo Ikäheimo, Matti Keloharju, Samuli Knüpfer

Is it smart to be thrifty? The authors show that cognitive ability influences mutual fund choice: High-IQ investors avoid funds with high management fees. Two competing stories can explain this phenomenon. One is that high-IQ consumers benefit less from costly services because they find it easier to make informed financial decisions without external help. The alternative story is that these investors are less likely to overpay for the services they receive because they are either better judges of value or more capable of discerning the price charged for these services. A comprehensive data set of Finnish males' fund holdings supports both stories: Consistent with the first story, high-IQ investors tend to avoid funds sold via expensive service-intensive channels and prefer a mix of equity and bond funds to expensive, readily packaged balanced funds. Consistent with the alternative story, IQ and fees are inversely correlated, even after controlling for many fund services, including any operating at the fund family level. The insight for management: Be smart; avoid mutual funds with high management fees.

Stock Ownership and Political Behavior: Evidence from Demutualizations (p. 945)

Markku Kaustia, Samuli Knüpfer, Sami Torstila

When a cooperative goes public, does it change political behavior in its operations? A setting in which customer-owned mutual companies converted to publicly listed firms created a plausibly exogenous increase in stock ownership. The authors use this shock to identify the effect of ownership of publicly listed shares on political behavior. They find that, when customer-owned mutual companies are converted to publicly listed firms, people change their voting in the affected areas, with the demutualizations being followed by a 1.7- to 2.7-percentage-point increase in right-of-center vote share. Demutualizations that did not involve public listing of shares suggest that explanations based on wealth, liquidity, and tax-related incentives do not drive the results. The insight for management: The ownership of publicly listed shares is instrumental in generating the increase in conservative voting in demutualizations.

The Persistence of Long-Run Abnormal Returns Following Stock Repurchases and Offerings (p. 964)

Fangjian Fu, Sheng Huang

Historically, the United States has experienced long-run abnormal returns after both stock repurchases and seasoned equity offerings. Why have they seemed to have disappeared for the events in 2003–2012? The authors suggest that the disappearance is associated with the changing market environment: increased institutional investment, decreased trading costs, improved liquidity, and enhanced regulations on corporate governance and information disclosure. In response to the more efficient pricing of stocks, firms become less opportunistic in stock repurchases and offerings. The authors suggest that recent events of stock repurchases and offerings are motivated more by business-operating reasons than to exploit mispricing. The insight for management: Both external market factors and internal firm factors contribute to the disappearance of the postevent abnormal returns.

Principal-Agent Settings with Random Shocks (p. 985)

Jared Rubin, Roman Sheremeta

How can employers (principals) discern low effort from bad luck when using outcomes to evaluate employee (agent) performance? The manager may use wage incentives to overcome incentive problems of the employee, but this is greatly reduced when the employee's effort is distorted by random shocks and transmitted imperfectly to the employer. The authors show that, with random events, both wages and effort are reduced, as are the probability of fulfilling the contract by the agent, the payoff of the principal, and total welfare. The insight for management: Random events place an important bound and create significant principal-agent problems.

Competition and the Efficiency of Markets for Technology (p. 1000)

Marie-Laure Allain, Emeric Henry, Margaret Kyle

What is the best time to separate the development of ideas from their commercialization in order to maximize the efficiency value of the specialization? The sale of ideas through licensing facilitates the division of labor between the separate activities of research and development. This vertical specialization can improve the overall efficiency of the innovative process. However, these gains depend on the timing of the sale: The buyer of an innovative project should assume development at the stage at which he has an efficiency advantage. Using data from the pharmaceutical industry, the authors show that competition between potential buyers is related to the timing of licensing. Furthermore, the effect differs by the type of competitor. The insight for management: Increased competition may increase licensing delays and hence inefficiency.

Do CIO IT Budgets Explain Bigger or Smaller Governments? Theory and Evidence from U.S. State Governments (p. 1020)

Min-Seok Pang, Ali Tafti, M. S. Krishnan

Do CIO IT budgets explain bigger or smaller governments? Given the recent concern about "big governments" and rising budget deficits in the United States and European nations, there has been a fundamental economic debate on the proper boundary and role of governments in a society. Inspired by this debate, the authors study the relationship between information technology (IT) and government size. The authors use a variety of data on IT spending and state government expenditures and find that greater IT investments made by a state chief information officer (CIO) are associated with lower state government spending. The insight for management: IT investments can be a means to restrain government growth; on average, a \$1 increase in state CIO budgets is associated with a reduction of as much as \$3.49 in state overall expenditures.

The Impact of Privacy Regulation and Technology Incentives: The Case of Health Information Exchanges (p. 1042)

Idris Adjerid, Alessandro Acquisti, Rahul Telang, Rema Padman, Julia Adler-Milstein

What is the impact of privacy regulation on health information exchanges (HIEs)? HIEs are healthcare information technology efforts designed to foster coordination of patient care across the fragmented U.S. healthcare system. Their purpose is to improve efficiency and quality of care through enhanced sharing of patient data. Across the United States, numerous states have enacted laws that provide various forms of incentives for HIEs and address growing privacy concerns associated with the sharing of patient data. The authors investigate the impact on the emergence of HIEs of state laws that incentivize HIE efforts and state laws that include different types of privacy requirements for sharing healthcare data, focusing on the impact of laws that include requirements for patient consent. They find that privacy regulation alone can result in a decrease in planning and operational HIEs, but, when coupled with incentives, privacy regulation with requirements for patient consent can actually positively impact the development of HIE efforts. Among all states with laws creating HIE incentives, only states that combined incentives with consent requirements saw a net increase in operational HIEs; HIEs in those states also reported decreased levels of privacy concern relative to HIEs in states with other legislative approaches. The insight for management: The impact of privacy regulation on the success of information technology efforts is heterogeneous; both positive and negative effects can arise from regulation, depending on the specific attributes of privacy laws.

Online Shopping Intermediaries: The Strategic Design of Search Environments (p. 1064)

Anthony Dukes, Lin Liu

How does online marketplace design affect search behavior? An online shopping intermediary is an Internet platform on which consumers and third-party sellers transact. Shopping intermediaries provide a search environment (e.g., search aids) to lower the search costs incurred by consumers when finding and evaluating sellers' products. The authors study strategic incentives of an intermediary in the design of its search environment as a means to ease search costs. They evaluate how consumers optimally decide how many sellers to evaluate and how deeply (e.g., number of attributes) to evaluate each of them. The insight for management: Sufficiently high search costs help to prevent consumers from evaluating too many sellers, but they should not be so high as to cause them to evaluate sellers' products at partial depth.

**Optimal Allocation Without Money:
An Engineering Approach** (p. 1078)
Itai Ashlagi, Peng Shi

How should goods be allocated when no money is involved? Examples include the allocation of seats in public schools, spaces in college dorms or courses, and positions in medical residency programs. Each person has individual preferences based on multiple criteria. The decision maker's goal is to maximize a potentially complex public objective while being mindful of any public costs. The authors apply their method to real data from Boston to design a mechanism that assigns students to public schools in order to maximize a combination of utilitarian and max-min welfare, subject to capacity and transportation constraints. The insight for management: Problems with more than 868 types of students and 77 schools can be translated to a solution that outperforms the baseline plan chosen by the city in terms of efficiency, equity, and predictability.

**Efficient Implementation of Collective Extended
Producer Responsibility Legislation** (p. 1098)
Luyi Gui, Atalay Atasü, Özlem Ergun, L. Beril Toktay

How should collective extended producer responsibility (EPR) legislation be structured? EPR is a policy tool that holds producers financially responsible for the post-use collection, recycling, and disposal of their products. However, these policies can be expensive. Many EPR implementations are collective—a large collection and recycling network (CRN) handles multiple producers' products in order to benefit from scale and scope economies. The total cost is then allocated to producers based on metrics such as their return shares by weight; however, every producer has different products with different features that affect the costs of their management. The consequence is cost allocations that impose higher costs on certain producer groups than they can achieve independently. This may lead some producers to break away from collective systems, resulting in fragmented systems with higher total cost. Yet cost efficiency is a key legislative and producer concern. The authors suggest cost allocation mechanisms that induce participation in collective systems and maximize cost efficiency. The insight for management: The widely used return share method can be improved to include the weighing of return shares based on processing costs and the rewarding of capacity contributions to collective systems.

**The Impact of Workaround Difficulty on Frontline
Employees' Response to Operational Failures:
A Laboratory Experiment on Medication
Administration** (p. 1124)
Anita L. Tucker

What is the impact of work design factors on responses to operational failures? Operational failures persist

in part because employees work around them without engaging in actions to prevent recurrence. The author uses hospital nurses as subjects in a laboratory experiment, where, unknown to them, two medication administration supplies are missing. The author observes their real-time responses to the two failures and whether they contribute an improvement idea. The author randomly assigns half of the participants to an experiment location far away from a satellite pharmacy where the missing supplies can be obtained ("difficult condition"), and the other half are located near the satellite pharmacy ("easy condition"). The author finds that participants in the difficult condition are more likely to contribute improvement ideas but are less likely to use policy-compliant workarounds. The participants in the difficult condition who have high access to the process owner are more likely to use policy-compliant workarounds than when they have low access. The insight for management: Hospitals can increase communication about operational failures by deliberately making it difficult to work around them while simultaneously providing a high level of access to process owners. Otherwise, nurses encountering operational failures are likely to resort to against-policy workarounds, a behavior observed in practice.

Ad Revenue Optimization in Live Broadcasting
(p. 1145)
Dana G. Popescu, Pascale Crama

What is the best pricing and scheduling strategy for planning advertisements when the number and duration of ads are not known in advance? In live broadcasting, the break lengths available for commercials are not always fixed and known in advance (e.g., strategic and injury time-outs are of variable duration in live sports transmissions). Broadcasters actively manage their advertising revenue by jointly optimizing sales and scheduling policies. The authors describe ways to help solve ad scheduling problems. Their approach performs well in most cases. The insight for management: There are ways for broadcasters to balance their portfolio of booked ads by determining the optimal overbooking level and mix of ads as a function of their associated revenues generated and penalties incurred.

**Design and Control of Public-Service Contracts
and an Application to Public Transportation
Systems** (p. 1165)

Andrea Lodi, Enrico Malaguti, Nicolás E. Stier-Moses, Tommaso Bonino

How should privately provided public transportation systems be structured to improve costs and quality? Until the end of the 20th century cities commonly organized, financed, and managed their own public transportation systems. More recently, many countries have liberalized the service provision of public trans-

portation. Although offering local public transportation is a political and financial duty of governments, the service provision is outsourced to a private operator, while the government retains a control position, given to a regulatory agency. This is a common scheme not only in transportation. In close collaboration with the public transportation agency of the city of Bologna, Italy, the authors designed a methodology to optimize some aspects of the contractual relationship between that agency and the bus operator. They focused on the fines specified by the contract when the operator fails to comply with the service level it has agreed to provide and on a procedure to measure that service level. The approach has the advantage that it aligns the incentives of both parties to the benefit of bus riders. The insight for management: There is a strategy of quality indicators and charges for failure that create improved contracting cost and performance for privately provided public transportation.

The Impact of Modeling on Robust Inventory Management Under Demand Uncertainty (p. 1188)
Oğuz Solyali, Jean-François Cordeau, Gilbert Laporte

Are there computationally efficient formulations for planning inventory management with order costs and demand uncertainty? The authors consider a basic inventory management problem with nonzero fixed-order costs under interval demand uncertainty. The insight for management: A new heuristic not only

is superior to the other formulations regarding the computing time needed, but also outperforms the existing robust formulations in terms of the actual cost savings on the larger instances.

A Matter of (Relational) Style: Loan Officer Consistency and Exchange Continuity in Microfinance (p. 1202)

Rodrigo Canales, Jason Greenberg

How does relationship affect consistency of performance in loan processing and client satisfaction? Three contributors affect microfinance: formal contracts, relational contracts, and relationally embedded social ties. Although each contributor has its virtues, all three exhibit a common limitation: an inability to fully explain the continuation and stability of intertemporal exchange between individuals and organizations in the face of change. The authors analyze data on approximately 450,000 microfinance loans made by a microfinance institution in Mexico from 2004 to 2008 that include random assignment of loan officers. They propose the concept of “relational styles” to help explain how repeated exchange is possible in the face of personnel change. They show that relational styles that are consistent facilitate a clear understanding of expectations and thus exchange. The insight for management: Relational style may be as important as individual relationships; turnover need not cause the loss of client connectedness to the organization.